Supreme Court, U.S.
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No. 96-775

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

TRAIL MOUNTAIN COAL COMPANY,
Petitioner,
v.

THE UTAH DIVISION OF STATE LANDS AND FORESTRY; RALPH MILES, DIRECTOR OF THE DIVISION OF STATE LANDS AND FORESTRY; THE UTAH DEPARTMENT OF NATURAL RESOURCES; DEE HANSEN, EXECUTIVE DIRECTOR OF THE UTAH DEPARTMENT OF NATURAL RESOURCES,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of the State of Utah

REPLY BRIEF FOR PETITIONER

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PARTIES TO THIS PROCEEDING

All parties to this proceeding are listed in the caption. Sup. Ct. R. 14(1)(b). Pursuant to Sup. Ct. R. 29.6, Petitioner submits the following supplemental statement regarding the ownership of Trail Mountain Coal Company:

> At the time the Respondent Utah Division of State Lands and Forestry conducted the 1985 coal production audit, Petitioner Trail Mountain Coal Company was a wholly-owned subsidiary of Arch Mineral Corporation. Although Arch Mineral Corporation subsequently sold Trail Mountain Coal Company, the contractual liability at issue here remains an obligation of Arch Mineral Corporation.

TABLE OF CONTENTS

	Page
PARTIES TO THIS PROCEEDING	i
TABLE OF AUTHORITIES	iv
INTRODUCTION	1
I. TRAIL MOUNTAIN'S CONTRACT WAS IMPAIRED	1
A. The Lease Does Not Grant The State Unfettered Authority To Alter The Mineral Lease, And The Modification Impaired Trail Mountain's Reasonable Expectations	2
B. The Contractual Power Asserted By The State Conflicts With Established Authority And Merits Review	4
II. *ROMEIN* IS FULLY APPLICABLE AND MANDATES REVIEW	6
III. THE STATE'S NEWLY IMPOSED RATES ARE RETROACTIVE	6
IV. UTAH'S PROFFERED JUSTIFICATIONS FOR ALTERING THE LEASE DO NOT MEET THE HIGH STANDARD APPLICABLE TO A STATE'S MODIFICATION OF ITS OWN CONTRACTS	8
V. REVIEW IS MANDATED TO PRESERVE FUNDAMENTAL CONSTITUTIONAL PRINCIPLES UTAH HAS IGNORED	10
CONCLUSION	10

TABLE OF AUTHORITIES

CASES	Page
American Toll Bridge Co. v. Railroad Comm'n, 307 U.S. 486 (1939)	10
Appleby v. City of New York, 271 U.S. 364 (1926)	10
Barron v. City of Baltimore, 7 Pet. (32 U.S.) 243 (1833)	10
Continental Ill. Nat. Bank and Trust Co., 696 F.2d 692 (9th Cir.), *appeal dismissed*, 460 U.S. 1077 (1983)	5
Coombes v. Getz, 285 U.S. 434 (1932)	4, 10
Edwards v. Kearzey, 96 U.S. 595 (1877)	1, 3, 4
Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983)	3
Garris v. Hanover Ins. Co., 630 F.2d 1001 (4th Cir. 1980)	3, 5
General Motors Corp. v. Romein, 503 U.S. 181 (1992)	1, 4, 6
Holiday Inn Franchising v. Branstad, 29 F.3d 383 (8th Cir.), *cert. denied*, 115 S.Ct. 613 (1994)	3
In re Workers' Compensation Refund, 46 F.3d 813 (8th Cir. 1995)	9
Irving Trust Co. v. Day, 314 U.S. 556 (1942)	10
Landgraf v. USI Film Prods., 114 S.Ct. 1483 (1994)	7
Lynch v. United States, 292 U.S. 292 U.S. 571 (1934)	5
McCracken v. Hayward, 2 How. 608 (1844)	6
McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819)	1
Morely v. Lake Shore & Mich. S. Ry., 146 U.S. 162 (1892)	1, 5
Rapid Transit Corp. v. New York, 303 U.S. 573 (1938)	10
Rosebud Coal Sales Co., Inc. v. Andrus, 667 F.2d 949 (10th Cir. 1982)	9
SCM Land Co. v. Watkins & Faber, 732 P.2d 105 (Utah 1986)	4
United States v. Winstar, 116 S.Ct. 2432 (1996)	5, 8

TABLE OF AUTHORITIES—Continued

	Page
United States Trust Co. v. New Jersey, 431 U.S. 1 (1977)	8, 10
Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940)	2, 3
Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535 (1867)	1
CONSTITUTIONAL PROVISIONS	
U.S. Const. art. I, § 10	10
STATUTES AND RULES	
Rules and Regulations Governing the Issuance of Mineral Leases	2, 3
Sup. Ct. R. 14(1)(b)	i
Sup. Ct. R. 29.6	i
Utah Admin. Code R. 850-200-4000(1)(a)	9
Utah Code Ann. § 15-1-1	2, 3, 4, 8
MISCELLANEOUS	
2 J. Story, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES, § 1383, pp. 252-53 (5th ed. 1891)	4

INTRODUCTION

"[C]hanges in the laws that make a contract legally enforceable" (*General Motors Corp. v. Romein*, 503 U.S. 181, 189 (1992)), such as the alteration of statutes establishing "the obligation[] of the debtor to pay interest after the maturity of the debt, where the contract is silent" (*Von Hoffman v. City of Quincy*, 71 U.S. (4 Wall.) 535, 550 (1867)), "trigger Contract Clause scrutiny if they impair the obligation of pre-existing contracts." *Romein*, 503 U.S. at 189. Here, a statutory 6% prejudgment interest rate that otherwise "would apply" to Petitioner Trial Mountain's contract (Pet. App. E 63a) has been displaced by new interest rates that increase the company's damage obligation by over $4 million. Trail Mountain Pet. 4-5.[1] This is plainly unconstitutional. *Morely v. Lake Shore & Mich. S. Ry.*, 146 U.S. 162, 168 (1892) (Contract Clause prevents retroactive alteration of prejudgment interest statutes). "The power to tax involves the power to destroy. * * * The power to modify at discretion the remedial part of a contract is the same thing." *Edwards v. Kearzey*, 96 U.S. 595, 602 (1878) (citing *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). None of the contentions in the State's Brief in Opposition ("Opp.") justify disregard of this constitutional reality.

I. TRAIL MOUNTAIN'S CONTRACT WAS IMPAIRED

Because Trail Mountain's contract was "issued subject in all respects to and under the conditions of the laws of the State of Utah and existing rules and regulations and such operating rules and regulations as may be hereafter approved and adopted by the State Land Board" (Resp. App. A 2a), the State argues "that there was no impairment of contract * * * because the contract itself permitted the State to act as it did." Opp. 12. The State also asserts that, as a participant in a regulated industry, Trail

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[1] The State implies that a mere "$1,854,115.69 in interest" is involved. Opp. 5. The record belies this tacit misrepresentation. The State has claimed $6,105,638.22 in interest (Pet. App. H 85a), not the $2,070,955.63 accrued under the 6% rate. Pet. App. C 32a.

Mountain took "the risk of future legislation." Opp. 14 (*citing Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32, 38 (1940)). These arguments are seriously flawed.

A. The Lease Does Not Grant The State Unfettered Authority To Alter The Mineral Lease, And The Modification Impaired Trail Mountain's Reasonable Expectations

The Lease does not allow the State to alter contractual terms at will. To begin with, the Lease was "granted subject in all respects to and under the conditions of the laws of the State of Utah." Opp. App. A 2a. This language, of course, expressly incorporates the 6% prejudgment interest rate of Utah Code Ann. § 15-1-1. Pet. App. E 73a (Bench, J., dissenting) ("[c]onsistent with the [State's] own analysis, the lease * * * is governed by section 15-1-1."). And, although the Lease is also subject "to existing rules and regulations" of the State Land Board and "such operating rules and regulations as may be hereafter approved" (Opp. App. A 2a), neither clause permits the State to modify the incorporated 6% interest rate.

When the Lease was granted in 1965, none of the Board's regulations addressed prejudgment interest or penalties for delinquent payments. The only monetary issues addressed in the regulations were application, bonding, and assignment fees, and rentals and royalties. Rules and Regulations Governing the Issuance of Mineral Leases (as amended October 13, 1966) (hereafter "Board Rules"), lodged with the Clerk of the Court. The Board did not undertake regulation of prejudgment interest or contractual penalties until 1982, some 17 years after it issued the Lease. Pet. 2, 4. Accordingly, the fact the Lease is subject to "to existing [*i.e.*, 1965] rules and regulations" (Opp. App. A 2a) hardly aids the State.

Nor does the fact that the Lease is subject to "such operating rules and regulations as may be hereafter approved" (Opp. App. A 2a) further the State's cause. "Operating rules and regulations" refer to regulatory pro-

visions that control the manner in which mines are operated.[2] The fact that the State has reserved a contractual right to apply future *operational* rules and regulations to an existing lease hardly confers upon the State the "power to modify at discretion the remedial part of a contract." *Edwards*, 96 U.S. at 602.

That mining is a regulated industry, finally, does not alter the above analysis. Although participants in a regulated industry may be on notice of possible future changes in state law, that notice is not limitless. Quite the opposite. This Court's decisions merely establish that "[w]hen [a party has] purchased into an enterprise *already regulated in the particular to which he now objects*, he purchased subject to further legislation *upon the same topic*." *Veix*, 310 U.S. at 38 (emphasis added).[3] When the Lease was issued in 1965, the State Land Board simply did not regulate leases "in the particular to which [Trail Mountain] now objects." *Id.* Instead, this "particular" was governed by Utah Code Ann. § 15-1-1(2), which provided that, "[u]nless the parties to a lawful contract specify a different rate of interest, the legal rate of interest * * * *shall* be 6% per annum." (Emphasis added). Trail Mountain, despite the State's protestations, had a

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[2] *See, e.g.*, Board Rule 24(c) (providing that "[t]he exploration for and the mining or recovery of salts from the surface of State lands * * * shall be conducted in such a manner as not to cause * * * the seepage of brines from one strata to another").

[3] *Accord Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 415 (1983) (cited at Opp. 9, 11, 14, 15) (retroactive application of gas price regulations did not violate Contract Clause only because, "at the time of the execution of the contracts, ERG did not expect to receive deregulated prices"); *Holiday Inn Franchising v. Branstad*, 29 F.3d 383, 384 (8th Cir.) (prior prospective regulation of franchises provided no fair warning that state would alter law retroactively), *cert. denied*, 115 S.Ct. 613 (1994); *Garris v. Hanover Ins. Co.*, 630 F.2d 1001, 1007 (4th Cir. 1980) (regulation of insurance industry did not alter impairment analysis because issue involved was "outside the [prior] range of state regulatory interest").

"reasonable expectation of a particular interest rate applying in the future." Opp. 15.[4]

B. The Contractual Power Asserted By The State Conflicts With Established Authority And Merits Review

The State's submission that it may alter the terms of its own contract is not only belied by the Lease, it conflicts with recent Court pronouncements. Rather than demonstrating this case's unimportance, the State's principal argument underscores the pressing need for review.

In *Romein*, this Court rebuffed the notion that the Contract Clause can be "entirely dependent on state law." 503 U.S. at 190. The Contract Clause, the Court wrote, cannot be avoided by legislatively providing " 'that all contracts thereafter made should be subject to the entire control of the legislature.' " 503 U.S. at 191 (quoting 2 J. Story, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES, § 1383, pp. 252-53 (5th ed. 1891)). Similarly, in *Coombes v. Getz*, 285 U.S. 434, 440 (1932), although State law provided that "[a]ll laws now in force * * * concerning corporations * * * may be altered from time to time or repealed," the repeal of a law rendering corporate directors contractually liable for corporate embezzlement did not reduce contractual liability for wrongs occurring prior to the repeal. "The authority of the state under the so-called reserved power is wide" but "not unlimited" and cannot be invoked to impair "the obligation of contracts." *Coombes*, 285 U.S. at 441-42.[5]

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[4] Utah's historical treatment of prejudgment interest, moreover, reinforces that expectation. An amendment *increasing* the rate of prejudgment interest under Utah Code Ann. § 15-1-1 is inapplicable to contracts negotiated *before* the effective date of the amendment, even though the contractual breach may have occurred *after* the higher rate has taken effect. *See, e.g., SCM Land Co. v. Watkins & Faber*, 732 P.2d 105, 109 (Utah 1986) (awarding prejudgment interest at six rather than ten percent because the "lease that was breached was executed prior" to the increase in the legal rate).

[5] *Accord Edwards*, 96 U.S. at 598, 604 (rejecting argument that legislation altering preexisting contracts never violates the Con-

Perhaps most importantly, the Court denied the United States last Term the very power claimed here: to avoid contractual language "merely by passing any 'regulatory statute.'" *United States v. Winstar*, 116 S.Ct. 2432, 2464 (1996). The Court denied the federal government this limitless ability, not only because of "concern with governmental self-interest" (*id.* at 2466 n.41) (Souter, J., joined by Stevens and Breyer, J.J.), but also because such a result "would flaunt the general principle that '[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.'" *Id.* at 2464 (*quoting Lynch v. United States*, 292 U.S. 571, 579 (1934)). *Accord id.*, 116 S.Ct. at 2477 (Scalia, J., joined by Kennedy and Thomas, J.J., concurring) (the effect of government contracts is "dictated by normal principles of contract interpretation").

Neither party to an ordinary contract would be granted the right to "change the interest rates to be applied upon [contractual] default." Opp. 15. *Winstar* counsels that this raw power should not be conferred on the States. *See Morely*, 146 U.S. at 168 (states may not retroactively alter prejudgment interest statutes). Because the rules announced in *Winstar* were drawn from the "application of the Contract Clause to public contracts" (116 S.Ct. at 2454), review is warranted to ensure that neither the federal government nor Utah is free to alter contract rights through action "tainted by a governmental object of self-relief." *Winstar*, 116 S.Ct. at 2465.

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tract Clause because "[t]he safety and health of the Commonwealth are above private right;" this "claim for the retrospective efficacy of * * * [state] laws cannot be supported"). *See also Continental Ill. Nat. Bank and Trust Co.*, 696 F.2d 692, 698-99 (9th Cir.) (State cannot impair the contractual provisions of bonds even though the bonds, as issued, were subject to "provisions of law as now or hereafter in effect"), *appeal dismissed*, 460 U.S. 1077 (1983); *Garris*, 630 F.2d at 1007 (State may not impair an insurance company's contract with an agent even though the company was statutorily required to "perform all duties now or hereafter prescribed by law").

II. *ROMEIN* IS FULLY APPLICABLE AND MANDATES REVIEW

The State struggles in vain to avoid the clear conflict between the opinion below and *Romein*. The "touchstone for Contract Clause analysis under *Romein*" is *not* whether State action "convert[s] a previously enforceable contract into a 'mere promise' " (Opp. 8), nor is that case limited to State infringement upon the "ability to enforce the bargained-for-terms" of a contract. Opp. 15. Rather, *Romein* clarified that *any* "changes in the laws that make a contract legally enforceable" will violate the Contract Clause "if they impair the obligation of pre-existing contracts, *even if they do not alter any of the contracts' bargained-for terms.*" *Romein*, 503 U.S. at 189 (emphasis added). An impairment of contract " 'necessarily' " exists, moreover, if " 'any subsequent law affect to diminish the duty, or to impair the right' " of a party to the contract. *Id.* (*quoting McCracken v. Hayward*, 2 How. 608, 612 (1844)).

Here, a 6% prejudgment interest term was incorporated in Trail Mountain's contract [6] and Trail Mountain had a reasonable expectation that this term would be enforced. Section I(A). The State's retroactive displacement of the term has trebled Trail Mountain's prejudgment interest obligation, "thereby impairing the contract's obligatory force." *Romein*, 503 U.S. at 189. The decision below simply disregards this analysis. That disregard demands review.

III. THE STATE'S NEWLY IMPOSED RATES ARE RETROACTIVE

The claim that the State's interest rates are not retroactive is, to repeat a phrase, "misleading at best." Opp. 16. The rates not only unilaterally changed the terms of a contract executed 17 years earlier, the rates have been applied to "remedy" a contractual breach that occurred three years before their adoption and six years before

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[6] While the State "assumes" the fact *"arguendo"* (Opp. 14), the Utah Supreme Court conceded that the 6% rate "would apply" absent retroactive regulatory action. Pet. E 63a.

Trial Mountain could have even been aware of the breach. Retroactivity, here, is clear. *Landgraf v. USI Film Prods.*, 114 S.Ct. 1483 (1994).

The royalty clause of Trail Mountain's contract is not as "unambiguous" as the State asserts. Opp. 17 n.8. Quite the contrary; the trial court initially concluded that the clause was impermissibly vague and, therefore, unenforceable. Pet. App. E 45a. Furthermore, as recognized by the Utah Supreme Court (App. A 4a), from at least 1979 through the completion of the State's 1985 audit, State employees repeatedly assured Trail Mountain that 15¢ per ton (rather than 8% of the value of coal produced) was the appropriate royalty. R. 2123.[7] There is, therefore, absolutely no support for the State's assertion that Trail Mountain "should have known from the beginning of [its] obligation to pay * * * the higher 8% rate." Opp. 17 n.8. Trail Mountain had no such knowledge (nor could it have) until the State announced (at the conclusion of the 1985 audit) that it was dramatically reinterpreting the Lease's royalty clause. Pet. at 3-5.

The State has nevertheless applied the Board's rates to calculate Trail Mountain's damage liability for a breach beginning in 1979 (three years before the rates were adopted) that continued through 1985—the first time Trail Mountain could have even been aware of the breach. Opp. 16 (conceding the rates have been applied to "Trail Mountain's outstanding delinquent balance"). This is not a situation where new regulations have been "applied prospectively to an existing contract." Opp. 16. As this Court recently explained, a law is retroactive if "the new provision attaches new legal consequences to events completed before its enactment." *Landgraf*, 114 S.Ct. at 1499. That is what has happened here. The State of Utah has "change[d] * * * the law[] that make[s] a contract legally enforceable" and has applied that law to "impair the obligation of [a] pre-existing contract[]." *Romein*, 503 U.S. at 189.

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[7] "R. 2123" refers to the paginated record before the Utah Supreme Court.

IV. UTAH'S PROFFERED JUSTIFICATIONS FOR ALTERING THE LEASE DO NOT MEET THE HIGH STANDARD APPLICABLE TO A STATE'S MODIFICATION OF ITS OWN CONTRACTS

The State's frail submission that any impairment of Trail Mountain's contract passes constitutional scrutiny (Opp. 18-21) is unavailing for four reasons. First, the applicable Contract Clause analysis is not the deferential "reasonableness" inquiry articulated by the State. Opp. 18, 20. It is, rather, the searching scrutiny " 'appropriate because the State's self-interest is at stake.' " *Winstar*, 116 S.Ct. at 2466 n.41 (quoting *United States Trust Co. v. New Jersey*, 431 U.S. 1, 26 (1977)). Second, even granting the State's duty to recover "full value" for school trust property (Opp. 18-20), that duty (for the reasons articulated in the Petition at 23-28) does not validate the retroactive trebling of Trail Mountain's prejudgment interest obligation.

Third, the State's assertion that its retroactive rates are "reasonable" (Opp. 19-20) is belied by the face of the Lease. The fact that the State might receive prejudgment interest at rates currently "below market" (Opp. 19) does not render Utah's retroactive displacement of the 6% contractual interest rate "reasonable." The Utah Code gave the State the power to negotiate whatever prejudgment interest rate (including a floating rate) that it determined was appropriate in light of the circumstances in 1965. Utah Code Ann. § 15-1-1(1) (parties may agree upon "any rate of interest"). The allocation of risks for nonperformance adopted by the State in 1965, when it bypassed the opportunity to negotiate rates and instead relied upon the 6% term, cannot be undone simply because (in hindsight) the State regrets that action. *Cf. Winstar*, 116 S.Ct. at 2458 (federal government cannot escape a "risk-shifting agreement[]" later deemed improvident).

The State, in any event, has ample contractual power under the terms of the Lease to protect itself against any "unforseen" rise in "market rates." Opp. 17. After

20 years, the Lease specifically provides for "readjustment of terms and conditions * * * as the Lessor may determine to be necessary in the interest of the State." Resp. App. A 2a. This clause—if invoked[8]—would have permitted the State to reissue and adjust the Lease in 1985 to apply to any future breach the rates the State adopted in 1982. *See* Utah Admin. Code R. 850-200-4000(1)(a) ("failure * * * to accept the terms of any readjustment * * * shall subject the lease to forfeiture"). Because the State had the contractual power to protect itself against the "unforseen" events raised by the Opposition (at 17-20), the State's retroactive impairment of the Lease is hardly "reasonable."[9]

Fourth, and finally, the claim that the contractual impairment should be upheld because "[i]t is difficult to find sympathy for Trail Mountain" has a particularly hollow ring. Opp. 17. Trail Mountain had a reasonable expectation that, upon breach, any prejudgment interest would accrue at 6%. Section I. That expectation, under the decisions of this Court, is constitutionally protected. Section II. Trail Mountain, furthermore, could not have known that it was even in breach until 1985—three years *after* the Board promulgated its retroactive rates. Section III. Nevertheless, Utah has adamantly insisted on retroactively collecting these rates.

Little wonder that Trail Mountain has pursued an "unremitting litigation strategy." Opp. 17. The "strategy," however, has not been "to avoid paying the school

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[8] A contractual right to mineral lease readjustment must be properly invoked at the end of the appropriate time period or it is waived. *See, e.g., Rosebud Coal Sales Co., Inc. v. Andrus*, 667 F.2d 949, 953 (10th Cir. 1982).

[9] Lease readjustment is the kind of permissible, prospective action discussed at page 16 of the State's Opposition. *See In re Workers' Compensation Refund*, 46 F.3d 813, 819 (8th Cir. 1995) (allowing new statute to govern *future* economic transactions between the State and its contractors because, "[u]nlike retroactive amendment, prospective amendment does not affect settled plans or arrangements").

trust anything." *Id.* Rather, the "strategy" merely has been to prevent Utah from unconstitutionally impairing the Lease in its own favor. Trail Mountain will pay Utah its due—but not its unconstitutional due.

V. REVIEW IS MANDATED TO PRESERVE FUNDAMENTAL CONSTITUTIONAL PRINCIPLES UTAH HAS IGNORED

Utah's final argument is that the case "involves the interpretation of a state mineral lease," not the Contract Clause. Opp. 21-22. The State errs. As recognized in *Romein* (503 U.S. at 187), whether a contract has been made, whether it has been impaired, and whether the impairment is constitutional are questions of federal—not state—law. *Irving Trust Co. v. Day*, 314 U.S. 556, 561 (1942); *American Toll Bridge v. Railroad Comm'n*, 307 U.S. 486, 490 (1939); *Rapid Transit Corp. v. New York*, 303 U.S. 573, 595 (1938); *Coombes*, 285 U.S. at 441; *Appleby v. City of New York*, 271 U.S. 364, 380 (1926). And, as shown in this Reply and the Petition, the opinion below does violence to established precedent controlling these questions. This case, therefore, turns upon "substantial constitutional principles." Opp. 21. The State simply invites the Court to ignore those principles.

The State's invitation should not be accepted. As Chief Justice John Marshall wrote, the limitations of Art. I, § 10, which include the Contract Clause, operate upon the States "in the nature of a bill of rights." *Barron v. City of Baltimore*, 7 Pet. (32 U.S.) 243, 248 (1833). The State of Utah has disregarded a fundamental limit on its own power. The Court should grant review to maintain that limit as part of "our written Constitution." *United States Trust*, 431 U.S. at 16.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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